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C O N F I D E N T I A L SECTION 01 OF 03 CARACAS 003402

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ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD
NSC FOR DTOMLINSON

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SUBJECT: SERVICE COMPANIES FACE A NEW GAME: JOINT VENTURES

Classified By: Acting Economic Counselor Shawn E. Flatt for Reason 1.4
(D)

11. (C) SUMMARY: The BRV and PDVSA have announced in very vague terms that it expects service companies to enter into joint ventures in order to provide goods and services to PDVSA. It appears that the joint ventures will be limited to individual downstream projects at this point, but service company executives believe PDVSA plans on extending the reach of the initiative. The BRV originally planned for companies to sign Memoranda of Understanding (MOU) at a special event with President Chavez the week of November 6, but the event was canceled. It appears that none of the service companies are ready to sign MOUs. We believe the BRV's motivation for launching the initiative at the present time is a mix of perceived operational benefits, electoral politics, and President Chavez's perceived need to control key elements of the Venezuelan economy. END SUMMARY

LET'S MAKE A DEAL

12. (C) Energy Minister and PDVSA President Rafael Ramirez called a meeting of service company executives on short notice in early October in Maracaibo to announce that PDVSA expected service companies to form joint ventures in order to provide goods and services to PDVSA. A number of senior PDVSA officials attended the meeting. Under the proposal, PDVSA would control 60 percent of the new joint ventures, international services companies 30 percent, and local companies 10 percent.

13. (C) PDVSA then held two follow-up meetings in Cumana. According to one version of events, Carlos Figueredo, the PDVSA official in charge of offshore development, called the Cumana meetings in order to show his zeal for the proposal and perhaps gain control of the process. At one of the Cumana meetings, Figueredo specifically mentioned Halliburton, Schlumberger, and Baker Hughes as candidates for

joint ventures. A Halliburton executive told Petroleum Attache (Petatt) on November 14 that PDVSA has since backed away from Figueredo's comments. The executive stated that PDVSA is now stating the proposal will only apply to individual downstream projects and Venezuelan service companies. He added, however, that Halliburton believes that the joint venture initiative will gradually be extended to upstream projects and international service companies.

14. (C) A Schlumberger executive told Petatt on November 6 that PDVSA was circulating a 16 page MOU that it was encouraging service companies to sign. The executive described the MOU as "very vague". According to local oil analysts, service companies were supposed to sign their MOU at a public event with President Chavez the week of November 6 but the event was canceled. According to the Halliburton executive, Ramirez met with Petroleum Chamber of Venezuela President Antonio Vincentelli recently regarding the joint venture initiative. Ramirez asked Vincentelli how many of the Chamber's members had signed a joint venture MOU and Vincentelli replied none. When Ramirez asked why, Vincentelli replied the proposal was so vague that none of his members were willing to sign until they had a better idea of the rules of the game. Ramirez ordered PDVSA officials to distribute a questionnaire to Petroleum Chamber members in order to determine what changes are necessary in order to make the MOU acceptable.

THE DATING GAME

15. (C) As part of its joint venture initiative, PDVSA has
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organized a series of meetings to encourage local and international companies to link up. Accounts of the meetings vary widely. It appears that in at least one meeting PDVSA officials made a real effort to encourage joint ventures that would offer synergy to the individual companies. However, a Mitsubishi executive told Petatt that in one meeting representatives from various service companies were randomly assigned seats at tables and then told to work out joint ventures.

THE 64,000 DOLLAR QUESTION

16. (C) It is not clear at this point how willing service companies are to play the joint venture game. As noted above, companies are loathe to play until they actually know what the rules of the game are. At this point, it is not clear what PDVSA's role will be in the proposed joint ventures.

17. (C) In addition, it is also not clear what international companies are supposed to bring to the table. The Schlumberger executive stated he believes the BRV wants to see service company joint ventures in order to gain access to goods and services that are hard to come by due to high worldwide demand; receive preferential pricing in order to avoid sharply higher prices due to high demand; and benefit from technology transfers. It is not clear how willing international companies will be to extend preferential pricing and service to PDVSA. It is hard to believe that the international companies will be willing jeopardize their intellectual property rights.

18. (C) Although PDVSA needs the service companies in order to maintain production, it has three significant cards that it can play. First, it owes all of the service companies large sums of money for past services. The Halliburton executive stated it takes PDVSA on average 120 days to pay service companies. He noted the situation is difficult for a company the size of Halliburton and stated he did not know how the small, local companies survive. When Halliburton executives mentioned the local companies to PDVSA executives in payment

negotiations, they treated it as a joke and laughed about how the local companies work for PDVSA for free.

¶9. (C) PDVSA's second card is that it can assign all future projects to joint ventures. As a result, local companies would be faced with the prospect of joining joint ventures or extinction. PDVSA has stated that joining joint ventures is voluntary but service company executives are skeptical of the claim. Local analysts have pointed out that social production companies were originally a voluntary measure but are now a requirement for doing business with PDVSA. The analysts also noted Susana Manzano, the head of the social production company program, was named head of the service company joint venture initiative. (COMMENT: Service company executives widely view the joint venture initiative as an invitation for corruption. The Mitsubishi executive believes the initiative will result in the direct assignment of projects rather than open competition. He noted PDVSA as a partner in the various joint ventures has an obvious conflict of interest since it is also awards the projects. END COMMENT)

¶10. (C) The final card PDVSA has to play is the fact that the major international service companies have invested significant sums in a wide range of facilities. Baker Hughes has a major production facilities in the Maracaibo area. Both Halliburton and Schlumberger have major facilities in various regions of Venezuela. Halliburton has a fully equipped barge operating in Venezuela that is worth 21

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million USD. It will be extremely difficult for any of these companies to walk away from such major investments as well as the huge sums that PDVSA owes them.

COMMENT

¶11. (C) Given the lack of details in the new joint venture initiative, it is difficult to determine what impact it will have on service companies. We expect PDVSA and the BRV to gradually flesh out the proposal but we do not believe they will provide meaningful details in the short to mid-term. Between the presidential elections, the continuing migration of operating service agreement fields to joint ventures, and the current negotiations to migrate the strategic associations to joint ventures, we find it hard to believe that senior BRV and PDVSA officials will have much time to devote to the service company initiative over the next six months. Having said that, we have no doubt that there will be eventually some sort of joint venture structure that service companies will have to adhere to in order to continue operating in Venezuela.

¶12. (C) As for the rationale behind the initiative, we agree with the Schlumberger executive's views as set out in paragraph 7 but believe that he left out two key factors. First, President Chavez has repeatedly stated publicly that his administration will do whatever it takes to make sure that there is never a repeat of the 2002-3 general strike. In order to accomplish that goal, Chavez believes the BRV must control all of the key sectors of the Venezuelan economy, with a particular emphasis on the hydrocarbon sector. By forcing the service companies to enter into joint ventures under PDVSA control, Chavez insures that a vital component of the hydrocarbon sector is entirely dependent on the BRV. Second, the signing of MOUs in a public ceremony right before the presidential elections would have given Chavez an excellent opportunity to claim once again that he is reclaiming Venezuelan sovereignty and using the country's resources to benefit the man in the street rather than soulless capitalists.

¶13. (C) It remains to be seen whether senior BRV and PDVSA officials are aware of the price they will have to pay for playing the joint venture game. An investment banker, who is

close to Energy Vice Minister Bernard Mommer, stated Mommer told him that he is strongly opposed to the initiative. He said Mommer regards the idea as "stupid". Service company executives have repeatedly told Petatt that they are unwilling to invest in major projects in Venezuela. Service company investment is basically being funneled into short term projects with rapid payoffs. The Halliburton executive said one of his competitors joked that his company only sends equipment to Venezuela that can be paid off in a year and has wheels. If oil prices do eventually decline, BRV and PDVSA officials may quickly find themselves faced with the need to quickly increase production in order to maintain BRV revenues and zero excess production capacity. At that point, they may find themselves begging the very service companies they are currently squeezing for major investments.

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